

ISSUE DATE: July 21, 1999

DOCKET NO. E-017/M-99-426

ORDER APPROVING REQUEST, GRANTING VARIANCE, AND REQUIRING NOTICE

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

Edward A. Garvey  
Joel Jacobs  
Marshall Johnson  
LeRoy Koppendrayner  
Gregory Scott

Chair  
Commissioner  
Commissioner  
Commissioner  
Commissioner

In the Matter of a Request by Otter Tail Power  
Company for Approval of Its 1998  
Conservation Cost Recovery Report, Demand  
Side Management Financial Incentives, and  
Annual Conservation Improvement Project  
Rider

ISSUE DATE: July 21, 1999

DOCKET NO. E-017/M-99-426

ORDER APPROVING REQUEST,  
GRANTING VARIANCE, AND REQUIRING  
NOTICE

**PROCEDURAL HISTORY**

In 1992, the Commission first approved a demand side management financial incentive mechanism for Otter Tail Power Company (Otter Tail or the Company).<sup>1</sup>

On November 13, 1995, the Commission approved a new demand side management (DSM) financial incentive program for Otter Tail.<sup>2</sup> The approved program consisted of the following components:

- a carrying charge on the Conservation Improvement Program (CIP) Tracker Account using Otter Tail's currently approved rate of return
- 100 percent lost margin recovery for lost kilowatt-hour sales of direct-impact projects
- a bonus incentive for direct-impact projects based on DSM energy savings
- a bonus incentive (and corresponding penalty clause) based on indirect-impact project performance

---

<sup>1</sup> In the Matter of the Proposal of Otter Tail Power Company for a Demand Side Management Financial Incentive, Docket No. E-017/M-91-457, ORDER ESTABLISHING DEMAND SIDE MANAGEMENT INCENTIVE PILOT PROJECT AND REQUIRING FURTHER FILINGS (March 12, 1992).

<sup>2</sup> In the Matter of a Request by Otter Tail Power Company for Approval of Its Demand Side Management Financial Incentive, Docket No. E-017/M-95-909, ORDER APPROVING DSM FINANCIAL INCENTIVE.

While noting that Otter Tail's DSM program could be reviewed, modified, or discontinued at any time in the future, the Commission clarified that its Order "...will not impose a sunset provision regarding the approved incentive. The incentive will remain in effect until further Order of the Commission." Order at p. 3.

On June 24, 1998, the Commission issued an Order approving Otter Tail's proposed demand side management recovery and CIP surcharge and deferring consideration of possible changes to overall DSM policy to a separate docket, No. E-999/CI-98-755.<sup>3</sup>

On April 1, 1999, Otter Tail filed a request for approval of its 1998 Conservation Cost Recovery Report, Demand Side Management Financial Incentives, and Annual Conservation Improvement Project Rider in the current docket.

On June 2, 1999, the Department of Public Service (the Department) filed comments. The Department stated that it had carefully reviewed Otter Tail's filing and related calculations. The Department concurred with Otter Tail's proposals for all four components of its DSM financial incentive program—the carrying charges, lost margin recovery, direct-impact bonus, and indirect-impact bonus. The Department recommended that the Commission approve Otter Tail's recovery of lost margins and bonuses and also the Company's proposed conservation surcharge of 1.50 percent for resource adjustment billings from July 1, 1999 through June, 2000.<sup>4</sup>

The Department noted that it has strongly supported the prospective elimination of lost margin recovery for all gas and electric utilities. The Department stated that it would base recommendations accordingly in Otter Tail's going-forward DSM incentive docket, E-017/M-99-510. In the present docket, however, the Department recommended approval of Otter Tail's proposed DSM recovery under the Company's currently approved financial incentive program.

On June 2, 1999, Ag Processing et al, a group of large energy customers, and the Suburban Rate Authority, a joint powers organization representing municipal corporations in the metropolitan area, filed joint comments opposing Otter Tail's proposed DSM recovery. AgProcessing argued that the Commission should deny Otter Tail lost margin and bonus recovery and lower the proposed conservation surcharge because the Company had failed to prove that it needs lost margin recovery or the requested CIP surcharge level to maintain its revenue requirement and authorized rate of return. AgProcessing argued that Otter Tail's incentives were unreasonable because they were disproportionately large in comparison to the Company's conservation investment.

On June 14, 1999, Otter Tail filed reply comments. Otter Tail argued that DSM incentive programs are tied to prudent investment in energy conservation, not to utility earning levels.

---

<sup>3</sup> Summary Order in Docket No. E-017/M-98-446.

<sup>4</sup> The Company's current approved conservation surcharge is 2.75 percent.

Neither past Commission practice nor sound regulatory policy require proof of utility under-earning for recovery under approved DSM programs.

On June 24, 1999, the matter came before the Commission for consideration.

At the June 24 meeting, Otter Tail requested a variance to Minn. Rules, parts 7820.3500(K) and 7825.2600 to allow the Company to combine the CIP Rider Adjustment and Fuel Clause Adjustment into one line item labeled “Resource Adjustment” on customer bills. AgProcessing opposed the request.

A representative of the Center for Energy and Environment, Izaak Walton League and Minnesotans for an Energy Efficient Economy appeared to support the Department’s comments and recommendations.

## **FINDINGS AND CONCLUSIONS**

### **I. FACTUAL BACKGROUND**

#### **A. Demand Side Management Financial Incentive Programs Generally**

In 1991, the legislature authorized, but did not require, the Commission to order utilities to file plans to compensate them for monies spent and profits lost due to their participation in conservation programs.<sup>5</sup> In February, 1991, the Commission issued an Order requiring all of Minnesota’s investor-owned electric utilities serving more than 500 Minnesota customers to file such plans, called demand side management financial incentive plans.<sup>6</sup> (Demand side management is a catch-all term for all methods of reducing resource needs through managing or reducing demand—conservation, energy efficiency, load management.)

In the parallel Order requiring gas utilities to file DSM plans, the Commission cautioned that these financial incentives were not necessarily permanent entitlements, but that they were appropriate regulatory tools at that time and place:

The Commission finds that it is sound regulatory policy to require gas utilities to file proposals for financial incentives to promote demand side management. Although energy efficiency and conservation are important goals, they appear to conflict, at least in the

---

<sup>5</sup> Minn. Stat. § 216B.16, subd. 6(c).

<sup>6</sup> In the Matter of a Summary Investigation into Financial Incentives for Encouraging Demand-Side Resource Options for Minnesota Electric Utilities and Bidding Systems, Docket No. E-999/CI-89-212, ORDER REQUIRING ELECTRIC UTILITIES TO FILE FINANCIAL INCENTIVE PROPOSALS IN 1991 (February 28, 1991).

short term, with utilities' natural self interest in maximizing profits...

The Commission will therefore require all gas utilities to file financial incentive proposals. By doing this, the Commission is not finding that financial incentives are in the public interest and should become a permanent part of gas utility ratemaking. It may turn out that financial incentives are useful primarily as devices to ease the transition from supply side management to a combination of supply side and demand side management. It may turn out that the role of financial incentives should be limited to encouraging utilities to find and implement the most cost effective conservation programs possible. For now, however, the Commission is convinced that the public interest requires serious consideration of financial incentive programs designed by individual utilities to increase their individual use of demand side management.

In the Matter of a Summary Investigation into Financial Incentives for Encouraging Demand Side Resource Options for Minnesota Gas Utilities, Docket No. G-999/CI-91-188, ORDER REQUIRING GAS UTILITIES TO FILE FINANCIAL INCENTIVE PROPOSALS (October 18, 1991).

All electric utilities included in the February, 1991 Order filed proposed financial incentive programs; all of them eventually had programs approved. These programs typically included recovery of some or all margins lost due to utility conservation programs, as well as bonuses for meeting specified conservation goals. Most companies developed adjustment mechanisms to adjust rates annually to recover conservation expenditures and demand side management financial incentives.

#### **B. The Commission's Notice of Further Investigation into DSM Financial Incentives**

In 1998, the Department filed comments in individual financial incentive recovery dockets claiming that financial incentives, especially lost margin recovery, had outlived their usefulness and should be discontinued. The Commission opened separate investigations into gas and electric financial incentives, later merged into a single investigation.<sup>7</sup>

---

<sup>7</sup> In the Matter of a Commission Investigation into Demand Side Management Financial Incentives for Gas and Electric Utilities, Docket No. E,G-999/CI-98-1759, ORDER AFFIRMING MERGER OF INVESTIGATIONS OF DEMAND SIDE MANAGEMENT FINANCIAL INCENTIVES FOR GAS AND ELECTRIC UTILITIES (December 17, 1998).

The Commission convened a Chair's Round Table to explore the issues and concerns the Department and other parties had raised regarding DSM.<sup>8</sup> In that Order the Commission put parties on notice that current DSM principles and practices would be subject to serious reevaluation.

Finally, the Commission puts all electric and gas utilities on formal notice that significant changes to current DSM financial incentive programs and methodologies may occur, possibly as early as January 1, 1999. The Commission notes that it will scrutinize and re-evaluate the advisability and viability of all aspects of the current DSM incentive program, including lost margin recovery, to decide if each aspect should be maintained, eliminated, or restructured.

Order at p. 5.

On April 16, 1999, Otter Tail filed its comments and proposals for future DSM treatment.<sup>9</sup> That docket is distinct from the current docket, in which the Company seeks recovery of 1998 DSM costs.

## **II. COMMISSION ACTION**

### **A. Otter Tail's Demand Side Management Filing**

#### **1. Introduction**

Before the Commission is Otter Tail Power Company's application for recovery of 1998 DSM costs. Otter Tail has filed for recovery of its 1998 lost margins, bonuses, and CIP tracker carrying charges, and for approval of its proposed CIP surcharge designed to recover its CIP tracker balance in the second half of 1999 and first half of 2000.

After careful analysis, the Department found that Otter Tail's proposed DSM calculations were accurate and that they fully complied with the methods authorized in the November, 1995 Order approving the Company's current financial incentive program. The Department noted with approval that Otter Tail had attempted to calculate lost margins accurately by estimating for each project the influence of such factors as persistence, free ridership and free drivership on actual energy savings. The Company also generally reduced the claimed energy savings for measures that had been in place for a number of years.

The Department noted that Otter Tail's CIP surcharge calculations were based on an assumption

---

<sup>8</sup> Docket No. E,G-999/CI-98-1759, ORDER CONVENING CHAIR'S ROUND TABLE AND REQUIRING FILINGS (December 2, 1998).

<sup>9</sup> Docket No. E-017/M-99-510.

that a phase-out of lost margin recovery would occur by 2001/2002 (although the Company presumed that a bonus incentive mechanism would remain) and on a goal of fully amortizing the tracker balance by the end of 2001. The Department believed that Otter Tail's reduced surcharge amount would benefit ratepayers, and that the Company could perform any necessary surcharge recalculations in the context of its going-forward DSM docket (No. E-017/M-99-510). In sum, the Department was fully satisfied with the Company's calculations, adherence to Commission Orders, and methodology refinements. The Department recommended approval of the Company's DSM filing.

## **2. Commission Decision**

The Commission agrees with the Department that Otter Tail should recover its 1998 DSM costs. In this case, the Commission is unpersuaded by the arguments of AgProcessing that the Commission should disallow the Company's DSM recovery. The Company has shown no pattern of over-earning which might warrant a hard look at overall reasonableness of rates under Minn. Stat. § 216B.03. To the contrary, Otter Tail has earned less than its authorized rate of return in the years relevant to this proceeding.

The Commission disagrees with AgProcessing's contention that the burden of proof falls on a utility in this set of circumstances to show that lost margins and CIP surcharges are the necessary means of reaching the proper earning level, or to justify revenue growth or an increase in returns. Otter Tail's rates, revenues, and rate of return were determined just and reasonable in its last rate case; Otter Tail is currently operating within the zone approved in that case. The mere act of filing for recovery under its approved DSM program does not trigger a further burden on a utility in these circumstances to prove that its rates--which include DSM recovery among many other factors--are reasonable. This is not to say that such a hard search could not and should not be undertaken in another set of facts. In this proceeding, no circumstance occurred to justify any further burden of proof for Otter Tail or any presumption against the Company's full recovery.

The Commission will grant Otter Tail its requested recovery of DSM costs.

## **B. Rule Variance to Allow a Combined Resource Adjustment on Bills**

### **1. Introduction**

Minn. Rules, parts 7820.3500(K) and 7825.2600 require utilities to report the fuel adjustment clause (either Fuel Clause Adjustment [FCA] or Purchased Gas Adjustment [PGA]) as a separate line item on customers' bills. In previous DSM Orders, the Commission has granted utilities a variance from these rules to allow them to combine the CIP adjustment with the FCA or PGA on bills. Otter Tail is currently combining this billing information under a variance from Commission rules.

In this case, Otter Tail did not request a renewal of the rule variance as part of its DSM filing, but did request the variance at the June 24 meeting.

AgProcessing opposed the request, arguing that its customers want the more complete information

that separate line items can provide and that combining billing costs is contrary to an industry move toward the unbundling of services.

## **2. Commission Decision**

The Commission in this case will grant Otter Tail's request for a variance to allow the Company to continue to combine CIP adjustment information with fuel adjustment information on customers' bills. The request fulfills the three criteria for granting a variance under the Commission's rules of practice and procedure, Minn. Rules, part 7829.3200.

First, enforcement of the rule would impose an excessive burden upon the utility and its customers. Otter Tail, as well as other electric utilities, has for years billed its customers using a combined CIP and fuel adjustment bill entry. The CIP adjustment, as well as every other aspect of DSM financial incentives, will be scrutinized in the Commission's prospective DSM dockets. Requiring a billing change at this time--for bills that will go into effect July 1, 1999--would be unproductive, confusing to customers, and excessively burdensome to the Company.

Second, granting the variance does not adversely affect the public interest. Stakeholders and other members of the public are beginning to study the benefits and drawbacks of a move toward greater service unbundling/customer choice. AgProcessing's contention that separate line items are necessary for informed customer choice can be debated in the context of the stakeholders' restructuring debate. Alternatively, the argument can be raised in various prospective DSM dockets. For the purposes of the current docket concerning recovery of 1998 DSM costs, the public interest is best served by continuation of a consistent and clear billing method.

Third, granting the variance does not conflict with any standards imposed by law. The requirement of a separate line item is a creature of Commission rule, not of statute. The Commission has the discretion to vary its rules if the variance meets statutory criteria.

### **C. Notice to Customers**

Effective July 1, 1999, Otter Tail's CIP adjustment will fall from its current 2.75 percent to the Company's proposed 1.50 percent. The change in the CIP surcharge will cause a change in rates outside a rate proceeding. In such situations, Otter Tail and other electric utilities have previously notified customers of the rate change, either by language added to bills or by bill inserts.

At the June 24 meeting, Otter Tail agreed that customer notice of the rate change would be appropriate and that Otter Tail would provide it.

The Commission will so order.

### **ORDER**

1. The Commission accepts Otter Tail's 1998 Conservation Cost Recovery Report, Demand Side Management Financial Incentives Report, and Annual Conservation Improvement Project Rider Update.
2. The Commission approves the addition of \$1,829,093 to Otter Tail's CIP tracker balance



for lost margins and incentives for 1998 CIP activities.

3. The Commission approves a CIP adjustment of 1.50 percent to applied to customer bills rendered on and after July 1, 1999.

4. The Commission grants a variance to Minn. Rules, parts 7820.3500(K) and 7825.2600 to

a  
ll  
o  
w  
t  
h  
e  
C  
I  
P  
R  
i  
d  
e  
r  
A  
d  
j  
u  
s  
t  
m  
e  
n  
t  
a  
n  
d  
t  
h  
e  
F  
u  
e  
l  
C  
l  
a  
u

s  
e  
A  
d  
j  
u  
s  
t  
m  
e  
n  
t  
t  
o  
b  
e  
c  
o  
m  
b  
i  
n  
e  
d  
i  
n  
t  
o  
o  
n  
e  
li  
n  
e  
it  
e  
m  
e  
n  
ti  
tl  
e  
d  
“

5. The Commission requires Otter Tail to notify customers of the change in the CIP adjustment, either by language added to the bill implementing the change or by bill insert.

6. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Burl W. Haar  
Executive Secretary

(S E A L)

This document can be made available in alternative formats (i.e., large print or audio tape) by calling (651) 297-4596 (voice), (651) 297-1200 (TTY), or 1-800-627-3529 (TTY relay service).